

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE**
300 Capitol Mall, 17th Floor
Sacramento, California 95814

REG-2007-00049

March 12, 2008

SUMMARY AND RESPONSE TO PUBLIC COMMENTS

PROPOSED AMENDMENT OF CCR TITLE 10, SECTIONS 2697.6 AND 2697.61

1. Commenter: Joe Zuber, California Earthquake Authority
Date of Comment: November 2, 2007
Type of Comment: Oral
Changes Requested: None

Summary of Comment: The CEA urges that the proposed amendments be approved. They serve two important and useful functions: to allow the CEA policy forms structure to be more flexible, so long as the policy captures the necessary coverages; and, to allow more flexibility in financing the supplemental limits program, which is needed when market conditions change as they have in recent years. Currently, because of the separate financial structure, the attachment point for reinsurance of the supplemental limits coverage is a small fraction of the attachment point for the reinsurance of the base limits coverages. Therefore, the rates for reinsurance for the supplemental limits program are much greater than the rates for the base limits coverages. Without the amendments, the CEA will find it increasingly difficult to buy reinsurance for and maintain the supplemental limits program and the CEA could see a significant drop in the number of Californians who carry earthquake insurance.

Response to Comment: Accepted

2. Commentor: Kimberly Dellinger, Personal Insurance Federation of California
Date of Comment: November 2, 2007
Type of Comment: Written
Changes Requested: None

(a) **Summary of Comment:** Combining finances of the two programs will allow the financial stability enjoyed by the base program to extend and benefit the supplemental program.

Response to Comment: Accepted.

(b) **Summary of Comment:** The proposed regulations would continue to require rates for the base limits and optional limits programs to each be actuarially sound on its own, with no cross-subsidies of one program by another.

Response to Comment: Accepted in part. Insurance Code section 10089.40(a) requires that all CEA rates be actuarially sound and the regulation continues to state that the sale of any optional limits insurance policies must be actuarially sound. However, the available capital that previously only supported the base coverages will now support both the base and supplemental coverages.

(c) Summary of Comment: The regulations will reflect the agreement reached during negotiation of SB 430 that each program will continue to stand on its own as it relates to rating, and that one program will not be used to subsidize another program.

Response to Comment: The Commissioner has considered this comment and rejects it as it is outside the scope of the proposed rulemaking.

(d) Summary of Comment: The proposed regulations do not modify the current mandatory offer obligations of CEA participating insurers under Insurance Code Section 10082(a).

Response to Comment: Accepted.

(e) Summary of Comment: The participating members of the CEA could continue to satisfy the aforementioned mandatory offer obligation by offering the base limits CEA policy without a mandatory offer of the optional limits coverages.

Response to Comment: The Department rejects this comment as being, in part, outside the scope of the proposed regulations. The Department agrees that a regulation cannot exceed the requirements of a statute (here the referenced Insurance Code section 10082 (a)) However, Insurance Code section 10082 (a) does not expressly preclude an insurer from being required to offer more than the minimum coverage levels stated in Insurance Code section 10089, (a) and (b). By its use of the language “the offer [...] shall include coverages,” etc., all that statute requires is that insurer must offer, *at least*, that much. Furthermore, Insurance Code section 10082(a) does not by its terms excuse CEA participating insurers from offering all available CEA coverages provided for under other Insurance Code provisions and CEA regulations, practices and procedures, and the regulations, as proposed to be amended, are in harmony with the code provisions noted.

3. Commenter: Richard De La Mora, Century-National Insurance Company

Date of Comment: November 1, 2007

Type of Comment: Written

Changes Requested: None

(a) Summary of Comment: The proposed regulations change the definition of base limits coverage to include a maximum 15% deductible rather than solely a 15% deductible and incorporate other coverages presently offered under the CEA’s Supplemental Program.

Response to Comment: Accepted.

(b) Summary of Comment: The Department has provided no evidence to support the conclusion that merging the programs will result in “expected overall saving[s]” in finance and reinsurance costs.

Response to Comment: The Department rejects this comment. The Department, the CEA, its participating insurers and interested parties who keep themselves informed about the business of the CEA understand that (1) the attachment point for reinsurance for the supplemental program is currently much lower than that of the base program, resulting in higher reinsurance rates for the supplemental program; (2) merging the two programs is reasonably calculated to allow the CEA to obtain reinsurance on more favorable terms than at present and at lower cost, without materially effecting the expenses associated with the base program, and at a higher attachment point and correspondingly lower cost, without materially affecting the costs for the base program; and, (3) the current reinsurance cost increases that the supplemental program has been experiencing have resulted not from any increased risk within the supplemental program, but from changing reinsurance markets, worldwide overall increases in the market cost of reinsurance, and the low attachment point of the supplemental program, which will be remedied by the merging of the programs.

(c) Summary of Comment: The merging of the programs will result in a transfer of risks and costs of the Supplemental program to the Base Program policyholders in violation of Insurance Code section 10089.40(a), excessive rates for the Base Program and inadequate rates for the Supplemental Program, an overall rate structure that is unfairly discriminatory, actuarially unsound and detrimental to the Base Program policyholders.

Response to Comment: The Department rejects this comment. Nothing in the proposed regulations will discharge the CEA from the requirement that CEA rates be actuarially sound as required by Ins. Code §10089.40.

(d) Summary of Comment: The transfer of financing/reinsurance costs from the Supplemental Program to the Base Program will violate the fundamental purpose underlying the CEA (making “basic residential earthquake policies” available and affordable) and will violate Insurance Code section 10089.6.

Response to Comment: The Department rejects this comment. To the contrary, merger of the programs is likely to favorably affect the availability and affordability of the CEA coverages. Nor does Insurance Code section 10089.6 prohibit the amendments.

(e) Summary of Comment: The transfer of financing/reinsurance costs from the Supplemental Program to the Base Program will cause an “adjustment” or “tempering” of the rates that should properly be charged for these two different coverage classifications, resulting in rates that are lower than justified for policies under the high risk of loss Supplemental Program and rates that are higher than justified for policies of low risk of loss base program classification in violation of Insurance Code section 10089.40(c).

Response to Comment: The Department rejects this comment. Reinsurance costs properly attributable to supplemental coverages will be included in the rates for those

coverages. Nothing in the proposed regulations will discharge the CEA from its obligation to provide actuarially sound rates for all of its coverages.

(f) Summary of Comment: The increase of Base Program rates attributable to the transfer of Supplemental financing/reinsurance costs will impact families that are not economically advantaged by making their insurance more expensive.

Response to Comment: The Department rejects this comment. No facts exist that could be reasonably interpreted as suggesting that the rates for base limits coverages will increase, or that there will be a transfer of costs between base and supplemental limits programs. Furthermore, no rates can change unless they are actuarially sound pursuant to Insurance Code section 10089.40.

(g) Summary of Comment: The proposed amendments will cause distortions in the earthquake market and allow the CEA to keep its rates artificially low and to unfairly compete in the earthquake market.

Response to Comment: The Department rejects this comment. Nothing in the proposed regulations will discharge the CEA from its obligation to provide actuarially sound rates pursuant to Insurance Code section 10089.40. Consequently, rates will not be “artificially” low or “artificially” high.